

Proposed Regulation 1671.1. DISCOUNTS, COUPONS, REBATES, AND OTHER INCENTIVES.

(a) IN GENERAL. Retailers often engage in marketing and sales programs in which they issue coupons or other indicia to their customers that entitle the customers to a reduction in the amount they are required to pay for products sold by the retailers. Manufacturers, vendors, and other third parties often engage in various programs that result in credits or payments made to retailers with respect to a retailer's taxable sale of products to an end-use customer. These payments and credits include, but are not limited to, purchase and cash discounts, coupon reimbursements, ad or rack allowances, buy-downs, scanbacks, voluntary price reductions and other incentives, promotions, and rebates. Under certain conditions, payments received by the retailer in the form of rebates or other types of payments or credits for products sold at retail are included in the retailer's gross receipts or sales price from the sale of the product.

(b) DISCOUNTS.

(1) CASH DISCOUNTS are offered by a retailer to its customer for prompt payment by that customer. If the customer makes prompt payment and takes the discount, the retailer's gross receipts are reduced by the amount of the discount. Cash discounts allowed and taken on sales are excluded from gross receipts. If, however, the customer does not make prompt payment, the retailer's gross receipts are the amount billed. Generally, discounts provided to customers utilizing a grocery store discount club card are regarded as cash discounts or retailer coupons.

(2) PURCHASE DISCOUNTS are given by a manufacturer and/or wholesaler to a vendor (i.e., a retailer) based upon the amount of prior or future purchases by that vendor. These discounts are regarded as trade discounts and are excluded from gross receipts as they are based on the number of products the retailer purchased from the manufacturer and/or wholesaler and not the number of products sold by the vendor at retail. Agreements wherein the retailer agrees to sell the products at a target price for a period of time are also "purchase discounts" and excluded from gross receipts when the discount is based on the number of products purchased by the vendor. The rebates received either directly from the manufacturer or from the wholesaler are not subject to tax since they are tied to the retailer's wholesale purchases of the products, not to the number of retail sales made at the target price.

(3) AD OR RACK ALLOWANCES are contractual agreements usually between a manufacturer and the retailer to advertise a product, or to give that product preferential shelf space. Ad or rack allowances are also known as "Local Pay," "Display Shelf Payments," or something similar. Such allowances are not related to the retail sale of the underlying product and are excluded from gross receipts. Generally, payments to a grocery store retailer pursuant to discounts offered through a grocery store discount club card are regarded as ad or rack allowances.

(4) RETAILER COUPONS are issued by a retailer in paper or paperless form. When presented to the retailer by the customer, they entitle the customer to buy tangible personal property at a certain amount or percentage off the advertised selling price. Although the coupons are presented to the retailer to receive a reduction in the selling price, retailer coupons do not result in compensation from a third party. If the customer has not paid any consideration for the coupon, e.g., a coupon clipped from a magazine or newspaper, the coupon represents a true price reduction resulting in a corresponding reduction in the retailer's gross receipts from the sale. If, however, the customer has previously given compensation to the retailer for the coupon, e.g., the coupon was purchased as part of a coupon booklet sold by the retailer to the customer, the pro rata share of the cost of the booklet represented by the purchase for which the coupon was given must be included in gross receipts.

(5) MANUFACTURER COUPONS are paper or paperless coupons funded by the manufacturer that customers can utilize at the time of purchasing the manufacturer's product, thus entitling customers to a certain amount or percentage off the advertised selling price. These coupons are generally identified as "manufacturer coupons" and include retailer reimbursement terms that must be followed by retailers in order to redeem the coupons. Amounts paid by a manufacturer to a retailer to reimburse the retailer for the value of the manufacturer coupon are included in the retailer's gross receipts. The retailer may, by contract, charge the customer sales tax reimbursement on the amount paid by the manufacturer. When a retailer charges such reimbursement, the amount on which the reimbursement is charged is fully disclosed to the customer through the customer's utilization of the manufacturer coupon.

(c) REBATES AND INCENTIVES.

(1) DEFINITIONS. For purposes of this subdivision only, the following definitions shall apply:

(A) "Discount" means a reduction in the amount of consideration the customer is required to provide in order to purchase the tangible personal property from a retailer as a result of third-party consideration promised to or received by the retailer.

(B) "Retailer's vendor" means a person who sells tangible personal property for resale directly to the retailer.

(C) Operative October 1, 2007, "third party" means a person other than the retailer or the retailer's customer, such as a manufacturer or retailer's vendor.

(2) REBATES ISSUED DIRECTLY TO CUSTOMERS. Manufacturers engage in promotional programs in which they offer product rebates directly to the retailer's customers following their purchase of the manufacturer's products. To receive the product rebate, customers are generally required to submit a rebate application form along with any required documentation (e.g., sales receipt) to the manufacturer or manufacturer's representative directly or through the retailer. Once the rebate form and required documents are processed and accepted, the manufacturer or the manufacturer's representative will issue the customer a rebate check. Rebates checks issued by manufacturers directly to the retailer's customers are not part of the retailer's gross receipts. In this situation, the customer pays the retailer the full selling price and receives a subsequent rebate directly from the manufacturer.

(3) REBATES AND INCENTIVES ISSUED TO RETAILERS. Retailers engage in rebate and incentive programs with manufacturers or other third parties that result in additional revenue for the retailer when certain conditions are satisfied. These are transactions involving buy-down programs, markdowns, discounts, coupons, rebates, and other price reductions. These rebate and incentive programs are also known as "Buy-Down Rebates," "Voluntary Price Reductions" "Promotions," "Flex" (Flex Extensions), "Coupon Redemptions," "Scanbacks," "Instant Rebates," or by a similar name.

(A) Operative October 1, 2007, when a retailer enters into an oral or written contract with a manufacturer or other third party that requires, on a transaction-by-transaction basis, a specific reduction in the retailer's selling price of specified products in exchange for a certain payment of a like amount from the contracting party (e.g., a payment that is not contingent upon selling a particular amount of the specified products), such payments received by the retailer are part of the taxable gross receipts or sales price of the sales. For purposes of this subdivision, it is rebuttably presumed that any consideration received by retailers from third parties related to promotions for sales of specified products is subject to tax until the contrary is established. The types of documentation that will generally rebut this presumption include, but are not limited to, the following:

1. A copy of an agreement or contract between the retailer and a third party that requires the retailer to give specified products preferential shelf space or to display the products in specific areas of the retailer's establishment in exchange for the payment received.

2. A copy of an agreement or contract between the retailer and a third party that provides the retailer with an advertising allowance, equal to or in excess of the payment received, when the retailer advertises the third-party's products.

3. A copy of an agreement or contract between the retailer and a third party that provides that the retailer will only receive the payment if the retailer sells a certain quantity of the products within a specified price range during a particular period, or if the retailer purchases a certain quantity of the products during a particular period.

4. In the absence of a written agreement or contract, the retailer may use any verifiable method of establishing that the consideration received from the third party was not subject to tax, such as a signed and dated letter or other type of documentation provided by the third party, subsequent to the contract or agreement, verifying that the payment received was not paid pursuant to a contract requiring a reduction in the selling price of specified products on a transaction-by-transaction basis.

(B) Operative October 1, 2007, for purposes of this subdivision, when a retailer contracts with its customer for the addition of sales tax reimbursement to the gross receipts of tangible personal property sold at retail, or when a retailer is obligated to collect use tax measured by the sales price, the retailer is required to disclose to the customer the amount upon which sales tax reimbursement or use tax is collected, including the amount of any taxable discounts, rebates, or incentives offered or paid to the retailer by third parties. The retailer may show the amount upon which sales tax reimbursement or use tax is collected on the customer's sales receipt, sales invoice, or other proof of sale. When applicable, the retailer may also post on its premises in a location visible to the customer, or in an advertisement or other printed material directed to customers, a notice to the effect that "tax" will be added to the selling price of all items, including the amount of any taxable discounts, rebates, or incentives offered or paid to the retailer by third parties.

A retailer that does not disclose the amount of any taxable discounts, rebates, or incentives upon which sales tax reimbursement is collected, is in violation of the provisions of Regulation 1700, *Reimbursement for Sales Tax*. A retailer obligated to collect the use tax that does not disclose the amount of any taxable discounts, rebates, or incentives is in violation of the provisions of Regulation 1686, *Receipts for Tax Paid to Retailers*.

(d) EXAMPLES.

(1) The following are examples of transactions where the value of the coupon or discount is part of the retailer's gross receipts (or sales price if subject to use tax) from the sale of the product:

(A) Customer clips a coupon out of a newspaper and presents it to the retailer at the time of sale to receive a discounted price on the product purchased. The coupon indicates "Manufacturer Coupon." Since the manufacturer will compensate the retailer for the amount of the price reduction and the customer presents a manufacturer coupon to the retailer, the value of the coupon is included in the retailer's gross receipts.

(B) Coupon on dog food bag indicates \$2 off at register. The coupon also indicates "payable by Big Bad Dog Food Co. (BBDF Co.)" or "All promotional costs paid by BBDF Co." The store clerk removes the coupon from the dog food bag and enters the amount of the discount into the register. The discount is included in the retailer's gross receipts.

(C) Retailer provides its customers with a coupon discount booklet containing coupons accepted by the retailer during sales periods. The booklet includes coupons identified as "manufacturer coupons" and retailer coupons. Customers remove the coupons from the booklet and present them to the check-out clerk. The value of the coupons identified as "manufacturer coupons" is included in the retailer's gross receipts. The value of the retailer coupons, however, would generally not be included in the retailer's gross receipts.

(2) The following are examples of transactions where rebate or incentive payments are part of the retailer's gross receipts (or sales price if subject to use tax) from the sale of the product:

(A) The retailer purchases dog food from a distributor, a separate legal entity from the manufacturer (BBDF Co.). No coupon is present on the dog food bag. However, a display notice indicates that a \$2 "price reduction is made possible by BBDF Co." Since the retailer agrees to reduce the selling price of the product in exchange for an offsetting reimbursement from the distributor, the discounted amount is included in the retailer's gross receipts.

(B) The retailer maintains an online sales Web site. The retailer enters into buy-down programs with manufacturers in which the manufacturers require the retailer to offer their products at a reduced price. When the customer purchases a discounted product, the customer's invoice lists the selling price less the amount of the manufacturer's discount. The amount of the discount is subject to tax.

(C) Retailer offers a grocery store discount club card. The customer uses the club card when purchasing various products. The customer also presents manufacturer coupons to the store clerk that are scanned along with the club card. Although the price reductions associated with the club card are not part of the retailer's gross receipts, the value of the manufacturer coupons is included in gross receipts.

(D) Retailer purchases cosmetic products directly from the manufacturer. The manufacturer and retailer enter into a buy-down program in which the retailer is required to reduce the selling price of the manufacturer's products. In turn, the manufacturer agrees to compensate the retailer for the amount of the price reduction. The rebate revenue is included in the retailer's gross receipts.

(E) A cola distributor enters into graduated rebate agreements with retailers that entitle the retailers to reimbursement from the distributor based on the number of 12-packs of cola the retailers sell at a required discounted price during the month of July. The amount of the sales discount is dictated by the distributor as follows. A participating retailer is certain to receive 50 cents for every 12-pack of cola the retailer sells in July at the required discounted price. However, after surpassing a minimum threshold of 12-pack units sold, the retailer will receive an additional 50 cents for each additional 12-pack sold over the threshold minimum. At the end of the promotional period, after verifying the number of 12-pack units sold, the distributor issues a rebate check to the participating retailer. Only the certain payment of 50 cents for every 12-pack of cola the retailer sells in July at the required discounted price is subject to tax. To the extent the retailer receives additional rebates for exceeding the minimum threshold, such contingent rebates are not subject to tax.

(3) The following are examples of transactions where the value of the coupon or discount is not included in the retailer's gross receipts (or sales price if subject to use tax) from the sale of the product:

(A) Retailer has store discount coupons printed in newspaper advertisements. The customers present the coupons when purchasing the advertised products. The retailer's coupon is not a third-party coupon, nor is the retailer reimbursed for the amount of the discount. Although the customers may present a coupon to the retailer, the amount of the discount is not included in the retailer's gross receipts.

(B) Retailer advertises a special promotional sale to a specific customer base. Qualifying customers are mailed a 25% discount coupon they may use on the last Tuesday of the month. The customers are required to bring the coupon to the store during the promotional period in order to receive a discount on their purchases. The retailer is not reimbursed by a third party for the discounted amount. The discounts provided to the retailer's customers qualify as nontaxable discounts.

(C) Retailer offers a "double discount" for certain manufacturer coupons used by customers. The customers present a manufacturer coupon offering \$1 off the purchase of a specific healthcare product. In turn, the retailer also allows an additional \$1 off the selling price of the healthcare product. Although the value of the reimbursable manufacturer coupon is included in the amount subject to tax, the retailer's additional \$1 discount qualifies as a nontaxable discount.

(4) The following are examples of transactions where rebate and incentive payments are not included in the retailer's gross receipts (or sales price if subject to use tax) from the sale of the product:

(A) A cola distributor enters into written agreements with retailers that entitle the retailers to compensation from the distributor based on the number of 12-packs of cola the retailers sell during the month of July. The retailers retain copies of the agreements. The retailers may or may not reduce the selling price of the 12-packs. At the end of the promotional period, the distributor issues rebate checks to the participating retailers. Given the retailers can document there was no requirement to reduce the selling price of the product, the additional revenue is not included in the retailers' gross receipts.

(B) A manufacturer enters into written agreements with retailers to advertise the manufacturer's products and to provide the products preferential shelf space. Retailers that agree to the manufacturer's terms receive compensation from the manufacturer at the end of the promotional period. Assuming the retailers can document that the agreements were not based on a selling price reduction, the payments from the manufacturer are not included in the retailers' gross receipts.

(C) A retailer's vendor agrees to discount the retailer's November purchases of Christmas products by 20% if the retailer's total sales for October exceed a specific amount. The retailer increases its purchases during October, gives the products preferential shelf space and advertises the products at 10% off. Although the retailer reduced the selling price of the products, a price reduction was not a condition of the agreement. The retailer retains documentation to support this fact. The discount is a reduction to the retailer's cost of good sold, not additional gross receipts.

(D) A manufacturer's representative enters into an agreement with a retailer that entitles the retailer to compensation from the manufacturer if the retailer's sales of the manufacturer's hair and skin care products exceed a specific amount during the month of June. The retailer offers the products at a reduced price and provides the hair care products with preferential shelf space. The retailer's sales for June exceed the specified amount and the manufacturer issues a check to the retailer, as agreed. The rebate payment is not subject to tax.

(E) A retailer buys products from either a wholesaler or the manufacturer of products. Retail sales of these products are generally subject to tax. The product manufacturer and/or the wholesaler enters into an agreement with the retailer for a rebate, based upon the number of products the retailer purchases from either the manufacturer or the wholesaler, if the retailer agrees to sell the products at a "target" price for a specified period. Typically, a target price is used to establish a general price range for a particular geographic area or demographic market. The rebates received either directly from the manufacturer or from the wholesaler are not subject to tax since they are tied to the retailer's wholesale purchases of the products, not to the number of retail sales made at the target price.

(F) During a routine audit of the retailer's books and records, the retailer is asked to provide documentation to support its nontaxable treatment of the revenue received; however, the retailer does not have sufficient documentation to support its reporting of the transactions in question. To verify that the revenue received from the manufacturer was not part of gross receipts, the retailer sends a letter to the manufacturer requesting that the manufacturer verify that the payment received under their promotional agreement was not paid pursuant to a contract requiring the retailer to reduce the selling price of their products. The manufacturer signs and dates the letter verifying this fact and returns it to the retailer. No concerns regarding the authenticity of the letter exist. Since the subsequent verification establishes that the rebate revenue was not paid in exchange for a required reduction to the retailer's selling price of the manufacturer's products, the revenue is not part of the retailer's gross receipts.

(5) The following are examples of transactions involving payments by automobile manufacturers to automobile dealers or end-use customers with respect to the sale or lease of automobiles.

(A) An automobile manufacturer provides a customer with a \$1,000 rebate upon the purchase of a specific automobile. Rather than receive payment from the manufacturer, the customer assigns the rebate to the dealer, who in turn applies the amount of that rebate toward the customer's payment for the vehicle. The \$1,000 payment by the manufacturer is part of the dealer's gross receipts, since the rebate is provided to the customer who uses the rebate amount to partially satisfy that customer's total payment obligation to the dealer. The \$1,000 rebate does not constitute a reduction in the retailer's gross receipts as a retailer's coupon, cash discount, purchase discount, or otherwise.

(B) An automobile dealer receives a \$500 incentive from the automobile manufacturer for every vehicle sold of a specific model in a given period. The manufacturer does not have an oral or written contract requiring the dealer to sell the specific model at a reduced price. The selling price is based solely on the dealer's discretion. Under these facts, the \$500 payment by the manufacturer is not part of the dealer's gross receipts since the manufacturer does not require a reduction in the retail selling price of the vehicle. The \$500 incentive instead constitutes a reduction in the dealer's cost of goods sold.

Authority Cited: Section 7051, Revenue and Taxation Code

References: Sections 6011, 6012, Revenue and Taxation Code
Gifts, Marketing Aids, Premiums and Prizes generally, see Regulation 1670
Trading Stamps and Related Promotional Plans generally, see Regulation 1671
Receipts for Tax Paid to Retailers, see Regulation 1686
Reimbursement for Sales Tax, see Regulation 1700